



# Economic Update

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## Healthy Economic Expansion Expected to Continue

### Overview

As the stock market broke the 11,000 mark this week – for the first time since 2001 – forecasters continued to project healthy economic expansion throughout 2006. Real growth in the gross domestic product is expected to remain at or above 3 percent, accompanied by steady job gains and historically low inflation and unemployment. Interest rates also are projected to remain low by historic standards, even though the Federal Reserve is expected to continue increasing short-term rates.

### Highlights

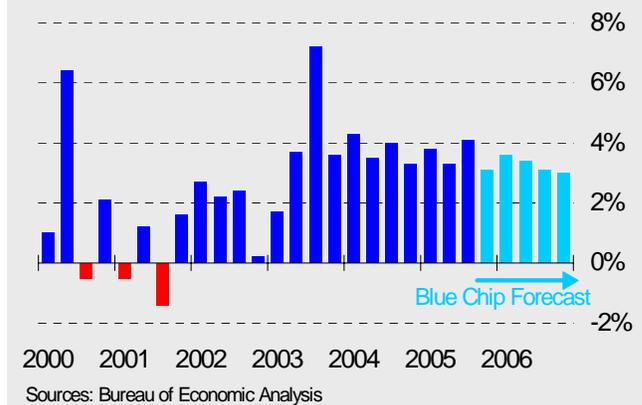
- Reflecting a slowdown in consumer spending, forecasters expect a moderation of growth in the inflation-adjusted (real) gross domestic product [GDP] to 3.1 percent for the 4<sup>th</sup> quarter of 2005. GDP growth is expected to accelerate in the first half of this year (Fig. 1).
- Labor markets have rebounded from the adverse effects of the Gulf Coast hurricanes. Following a surge of 305,000 new payroll jobs in November, job gains totaled 108,000 in December (Fig. 2, next page). The unemployment rate edged down to 4.9 percent in December from 5.0 percent in November.
- Despite significant increases in short-term interest rates, reflecting recent Federal Reserve policy, long-term interest rates remain relatively low. The yield on a 10-year Treasury bond, currently close to 4.4 percent, is not substantially higher than the yield on a 30-day Treasury bill, currently at around 4.0 percent (Fig. 3, next page).

### Growth Expected to Accelerate in First Half of 2006

GDP, a broad measure of the Nation's output of goods and services, grew at a rapid 4.1 percent rate in the 3<sup>rd</sup> quarter of last year, led by consumer spending, business investment, Federal spending, and residential investment. GDP growth has been at or above 3.3 percent for 10 straight quarters.

**Economic Growth Since 2000** Fig. 1

(Real annualized GDP growth rate in each quarter)



**Blue Chip Economic Outlook, January 2006**

	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	<i>Actual</i>				<i>Projection</i>			
<b>Real GDP Growth</b>	3.8	3.3	4.1	3.1	3.6	3.4	3.1	3.0
<b>Unemployment Rate</b>	5.2	5.1	5.0	4.9	5.0	4.9	4.9	4.9
<b>CPI Inflation</b>	2.5	4.0	5.3	3.4	2.0	2.3	2.2	2.3
<b>3-month Treas. Bill</b>	2.5	2.9	3.4	3.8	4.3	4.6	4.6	4.6
<b>10-year Treas. Note</b>	4.3	4.2	4.2	4.5	4.7	4.9	4.9	5.0

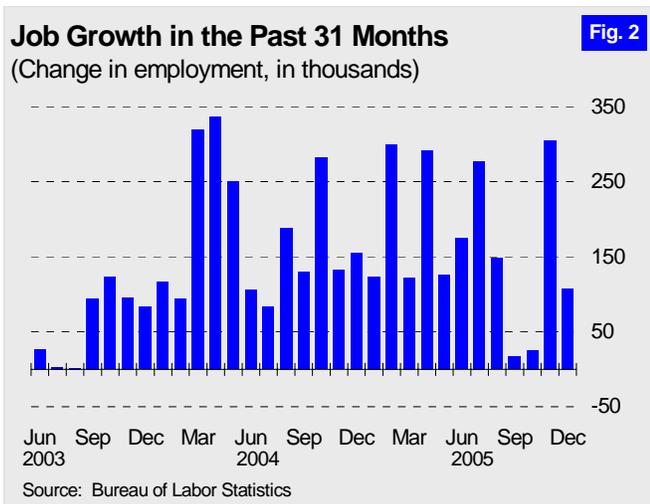
The *Blue Chip* forecast – a consensus of private forecasters that is updated each month – is for growth in real GDP to slow to a still-healthy 3.1 percent in the 4<sup>th</sup> quarter, reflecting slower consumer spending, followed by stronger growth in the first half of this year as businesses rebuild inventories and employment and wage gains serve to buoy consumer spending.

(continued on reverse side)

**Employment Increases, Unemployment Edges Down**

As noted, payroll employment rose by 108,000 jobs in December, following an appreciable 305,000 rise in November. There have been 31 consecutive months of job gains, adding more than 4.6 million new jobs to the Nation’s payrolls. Payroll jobs grew an average of 168,000 in 2005, increasing payroll employment by more than 2 million for the year. Payroll employment has expanded by more than 2 million jobs in each of the past 2 years. Forecasters project healthy job gains to continue in 2006, adding an estimated average of more than 175,000 new payroll jobs per month.

The unemployment rate fell to 4.9 percent in December from 5.0 percent in November. Unemployment has declined significantly over the past 2½ years, from a near-term peak of 6.3 percent in June 2003 to the current 4.9 percent. Over the past year, the unemployment rate has declined by half a percentage point.



**Expansion Continues in Manufacturing and Services**

The Institute for Supply Management [ISM] index of non-manufacturing (services) activity increased to 59.8 in December, from a value of 58.5 in November, indicating robust expansion in the services sector of the economy. An index value above 50 indicates expansion in the services sector; a value close to 60 indicates a vibrant pace of expansion. The ISM services index has been above 50 for 33 consecutive months. The services sector of the economy accounts for a majority of the Nation’s output

The ISM index of manufacturing activity eased in December to 54.2, from 58.1 in November, indicating continued expansion in manufacturing, but at a slower pace. The ISM index has indicated expansion in manufacturing for 31 consecutive months.

**Fed Expected to Continue Raising Short-Term Rates**

Markets expect that the Federal Reserve will continue its recent course of monetary policy by increasing short-term interest rates again at its policymaking meeting scheduled for the final two days of this month. The Fed has raised its target overnight interest rate from 1.00 percent to the current 4.25 percent in a sequence of quarter-point increases that began at the end of June 2004. The Fed is widely expected to change its target for overnight rates to 4.50 percent at the end of this month. Markets also expect a further increase to 4.75 percent following the Fed’s March 28 meeting.

**Trade Deficit Narrowed in November**

The trade deficit shrank by 5.8 percent in November to \$64.2 billion from a record \$68.1 billion in October, when the value of energy imports surged to make up for a drop in U.S. Gulf output after the hurricanes. Nonetheless, the November trade gap is the third highest on record and the gap for 2005 is headed for an all-time high of more than \$700 billion.

**Upcoming Indicators**

**Federal Reserve** - The Fed’s next policymaking meeting is scheduled for *January 31*.

**Employment** - The Bureau of Labor Statistics reports the January employment situation on *February 3*. Jobless claims data are issued every Thursday.

**GDP** - The first estimate of GDP for the 4<sup>th</sup> quarter is scheduled to be released on *January 27*.

**Inflation** - The Consumer Price Index for December is scheduled to be released on *January 18*.

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